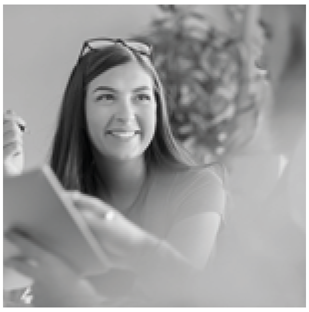
BEYOND THE TIPPING POINT

Where after High Cost Credit?

February 2025




CSJ The Centre for Social Justice

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About the Centre for Social Justice

Established in 2004, the Centre for Social Justice is an independent think-tank that studies the root causes of Britain's social problems and addresses them by recommending practical, workable policy interventions. The CSJ's vision is to give people in the UK who are experiencing the worst multiple disadvantages and injustice every possible opportunity to reach their full potential.

The majority of the CSJ's work is organised around five "pathways to poverty", first identified in our ground-breaking 2007 report, Breakthrough Britain. These are: educational failure; family breakdown; economic dependency and worklessness; addiction to drugs and alcohol; and severe personal debt.

Since its inception, the CSJ has changed the landscape of our political discourse by putting social justice at the heart of British politics. This has led to a transformation in Government thinking and policy. For instance, in March 2013, the CSJ report It Happens Here shone a light on the horrific reality of human trafficking and modern slavery in the UK. As a direct result of this report, the Government passed the Modern Slavery Act 2015, one of the first pieces of legislation in the world to address slavery and trafficking in the 21st century.

Our research is informed by experts including prominent academics, practitioners and policy-makers. We also draw upon our CSJ Alliance, a unique group of charities, social enterprises and other grass-roots organisations that have a proven track-record of reversing social breakdown across the UK.

The social challenges facing Britain remain serious. In 2024 and beyond, we will continue to advance the cause of social justice so that more people can continue to fulfil their potential.

Acknowledgements

The CSJ would like to extend our thanks to the many individuals and organisations who shared their time, expertise, evidence, and feedback in the preparation of this report. We would like to specially thank the supporters of the Debt Unit, including, Lowell, Aryza, Equifax, and Money Wellness who make our work possible.

We would like to thank Experian for providing us with much of the data used in this report. We would also like to thank all the individuals who have shared their expertise, evidence, feedback and time in the preparation of this report. This includes (but is by no means limited to): Experian, Simon Dewhirst, James Jones, and all other stakeholders who engaged with us.

Disclaimer: the views and recommendations in this report are those of the CSJ and do not necessarily represent those of the individuals or organisations mentioned above.

Executive Summary

Over the last decade and a half, there has been significant change in the unsecured credit market.[1] New products, such as Buy Now Pay Later, have grown their market share rapidly while other products, namely high-cost credit, have declined or almost disappeared entirely following intervention by Parliament and the Financial Conduct Authority in response to concerns about how those markets functioned.[2]

Innovation and change in the unsecured credit market has the potential to bring significant benefits to consumers by reducing their cost of credit and improving accessibility.[3] But disruption also has the potential to bring challenges with it. Where firms feel they cannot price risk to effectively account for the potential of default and/or cost of delivery and cannot raise funds to lend then they may exit the market entirely, leaving consumers without the access they once had.

This change need not necessarily be a bad thing where the market responds to this change by substituting one product for a cheaper, more efficient alternative. Where it doesn't, a gap may emerge where consumers are unable to access the amount and type of credit they wish to.[4]

Providing credit is always a nuanced decision that requires consumer checks and careful decision making. Actors across the market ought to be realistic about credit's ability to ameliorate all the challenges consumers face, particularly when living costs are heightened and where increasing affordability concerns means lenders of all market segments are tightening their lending criteria. To be clear, an ever-higher cost of borrowing as a consumer's risk profile increases is no substitute for economic growth that allows households on lower incomes to boost their economic outlook. Nor should we forget why Parliament intervened to clean up the consumer credit market.[5] Credit is not always the right option for many consumers for whom debt advice is a more appropriate avenue.

With that said, recent research released by ClearScore and the consultancy EY has highlighted a non-prime market that they believe is increasingly not working for lower income households who are more likely to be considered subprime borrowers.[6] The report notes how the high cost products non-prime users traditionally accessed have declined considerably as providers have exited the market and offer rates for sub-prime users rest at around 20 per cent, compared to 65 per cent for near-prime users and over 80 per cent for prime consumers.

1 Financial Conduct Authority, *The Woolard Review – A review of change and innovation in the unsecured credit market*.

2 Financial Times, *Buy now, pay later is here to stay and going mainstream;* Grant Thornton, *What's next for BNPL in 2024?;* The Motley Fool, *Death of the credit card? Young people shunning credit cards for one reason*.

3 *Legislation.gov.uk*, *Financial Services (Banking Reform) Act 2013*; Financial Conduct Authority, *High-cost Credit Review: Overdrafts policy statement*; Financial Conduct Authority, *Evaluation Paper 23/1: An evaluation of our 2019 overdrafts intervention*; Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit: Including feedback on CP14/10 and final rules*.

4 Financial Times, *The UK's credit gap will gape in this cost of living crisis*; Financial Times, *Crackdown on high-cost credit leaves gap that must be filled*.

5 Department for Business, Innovation and Skills, *Government response to Bristol University report on high cost credit; Gov.UK*, *Government takes action to tackle payday lending concerns;* Financial Conduct Authority, *FCA censures Amigo for failing to conduct adequate affordability checks*.

6 ClearScore, *Building a non-prime lending market that delivers for UK consumers*.

Fair4All Finance has also recently released a new report that argues that there is a growing credit vacuum of about £2 billion pounds and that recent regulatory reform and external factors mean the credit market is not functioning properly for lower income consumers.[7]

It is therefore to the non-prime, high-cost market we turn to in this paper. We draw together a range of data sources, including data from the Financial Conduct Authority and an analysis of 1 million consumers who have used high-cost credit after the initial collapse in the use of high-cost credit between 2012 and 2015 by the credit reference agency Experian. This analysis is comprised of two snapshot analyses of the 2017/18 and 2022/23 cohorts as well as a longitudinal analysis to understand what the 2017/18 cohort are doing today. We use this analysis to understand how the high-cost market has changed in relation to both its size and shape.

Broadly we find:

- There has been a significant decline in the size of the high-cost short term lending market.
- Many of the features that defined consumers borrowing high-cost credit in 2017/18 continue to define consumers borrowing in 2022/23. However, today's cohort appear to be considerably more credit active, showing greater use of non-prime credit cards and buy now pay later products.
- Consumers who borrowed high-cost credit in 2017/18 generally show stronger signs of financial health, displaying higher credit scores and lower indebtedness now after many of them have exited the high-cost market.
- Consumers who borrowed high-cost credit in 2017/18 appear to show different trajectories. Many consumers – some 115,000 - no longer appear in the data at all, while others other credit, including credit cards and buy now pay later products.

It is worth noting that this analysis tells us little about the population of people who are believed to have fallen out of the credit market and the reported rise in illegal lending because the analysis is confined to consumers who use products – such as credit - that appear in Experian's database. We also note that our analysis begins in 2017/18, after a substantial fall in the availability of high cost credit meaning we also do not comment on this cohort.

Where to go from here? The developments we find in our analysis and the wider commentary that exists elsewhere show a significant shift in the shape of the non-prime credit market. These developments need not be a bad thing where consumers are able to manage their finances in their newly recalibrated position or where they are able to access cheaper forms of credit. But there has been growing concern amongst both politicians and the industry that a gap has emerged in the market and that low-income households are unable to access affordable credit when they need it.[8] The Financial Conduct Authority also clearly takes this very seriously given its decision to list access to affordable credit as a priority in its portfolio letter of March 2024 and its decision to exempt some smaller lenders from its data submission requirements, citing the cost of its regulation to firms.[9]

Another question yet to be answered is for how long the existing lay of the land can remain. If many current and former high-cost credit customers have become more credit active and are accessing BNPL / Deferred Payment Credit it may be because high cost credit no longer meets their credit demands. This begs the question: what may they do if they cannot access BNPL in the future?

7 Fair4all Finance, *Access to credit and illegal lending: the shape of the market is as important as the size*; LEK, *Improving access to lending for the financially vulnerable*.

8 Fair4All Finance, *Access to credit and illegal lending*; Finance and Leasing Association, *Access to Credit: Next Steps;* Andrew Griffith MP, *Speech by the Economic Secretary to the Treasury, Andrew Griffith*.

9 Financial Conduct Authority, *PS24/3: Consumer Credit Product Sales Data Reporting*.

We do not claim to have all the answers, but we hope by publishing this paper, we encourage others to believe that discussing the state of the non-prime market is worthy of our time. We make three broad recommendations to encourage greater discussion between government, regulators, and industry and to chart a course for a successful non-prime sector that supports consumers when they access credit. We recommend that:

- The Financial Conduct Authority, in partnership with the Prudential Regulation Authority and HM Treasury, lead a broad-based stock take of the non-prime credit sector culminating in a joint 5-year strategy for the sector.
- The strategy should define clear expectations of the non-prime credit sector, including if any APR levels, product types, and business models are deemed to be unacceptable in the market. This will help provide clearer – although not conclusive – guidelines for firms and investors.
- The strategy should define what "success" looks like for the community credit sector – including credit unions and community development finance institutions – and how its ambitions can be achieved. We made a series of recommendations in *Swimming with Sharks* to grow the size of the credit union sector by encouraging the consolidation of the sector to create bigger, bolder credit unions.[10]

10 Centre for Social Justice, *Swimming with Sharks: Tackling illegal money lending in England*.

Introduction

Given the substantial change mentioned above, it is to the high-cost credit market we turn to in this paper. We draw together a range of data sources, including data from the Financial Conduct Authority and an analysis conducted for the Centre for Social Justice by the credit reference agency Experian to understand how the high-cost market has changed in relation to both its size and shape. Specifically, the high-cost lending market is defined as consumers who have taken either a home credit loan, a payday loan, or a loan from another established high-cost credit provider.

We use this data to explore the size and shape of the high-cost market in two snapshots from 2017/18 – after the initial substantial fall in the use of high cost credit – and 2022/23.These dates are chosen due to availability. We further explore how consumers who borrowed high-cost credit in 2017/18 are doing now. This section of the analysis provides a longitudinal analysis of these consumers, many of whom no longer use high-cost credit following a further subsequent fall in the use of these product.

Following this, we outline three broad recommendations for Government and the Financial Conduct Authority. These are: to set out a new strategy for the non-prime credit sector, define their expectations of the sector to provide greater certainty for consumers and firms, and finally to define "success" for the community sector and provide a roadmap to achieve it.

The structure of this paper is as follows:

- In Chapter 1, we shall briefly look at the changing size of the high-cost credit market. To do this, we draw together data from the Financial Conduct Authority to show the significant reduction in size of the market since 2012.
- In Chapter 2, we shall review the changing shape of the high-cost market. To do this, we draw on a cross-sectional analysis of administrative data from over 1 million consumers held and conducted by the credit reference agency, Experian. We shall show how many traits shown by consumers operating in the market remain broadly the same between 2017/18 and 2022/23.
- In Chapter 3, we shall explore a longitudinal analysis of consumers who used high-cost credit in 2017/18 to see how they stand today. This analysis was also conducted by Experian.
- Finally, in Chapter 4, we shall discuss what this means for the future of the non-prime credit market.

Chapter 1:

The Changing Size of the High Cost Credit Market

Over the last decade and a half, the size and shape of the high-cost credit market has changed substantially. A series of regulatory reforms starting in 2013 with the decision to implement a cap on the cost of high-cost short term credit, which was brought into force in 2015, prompted a sharp recalibration of the market.[11] In particular, that calibration took the form of a significant decline in the number of loan originations and the number of firms operating in the market.

The cause of this decline in size are manifold. New regulation introduced by Parliament and the Financial Conduct Authority sought to, and certainly has, improved consumer protection for borrowers, but it also prompted a decline in the size of the market which some argue means many riskier consumers do not benefit from improvements because they are no longer lent to. In the course of our discussions, we've been told that the retrospective application of new regulation - an argument now repeated in the context of motor finance claims - resulted in significant costs to firms, limited investment in the sector due to regulatory uncertainty, and departures from the market.[12]

Regardless of the validity of these claims, the size of the high-cost market has declined considerably, leaving fewer products for non-prime consumers who exhibit a high-risk profile. As noted above, we believe actors should be realistic about credit's ability to ameliorate all the challenges consumers face, but equally note that consumers may sometimes need to access credit.

Segmenting consumers in consumer credit.

For context, this box explains what we mean by subprime, near prime and prime consumers. In consumer credit, consumers are generally referred to as prime, near prime or subprime and these terms generally relate to their credit score.[13] A credit score is a prediction of credit behaviour, such as how likely a consumer is to pay back a loan on time, based on information from credit reports. Some lenders use open banking to determine consumer's ability to repay.

11 Financial Conduct Authority, *High-cost credit and consumer credit*.

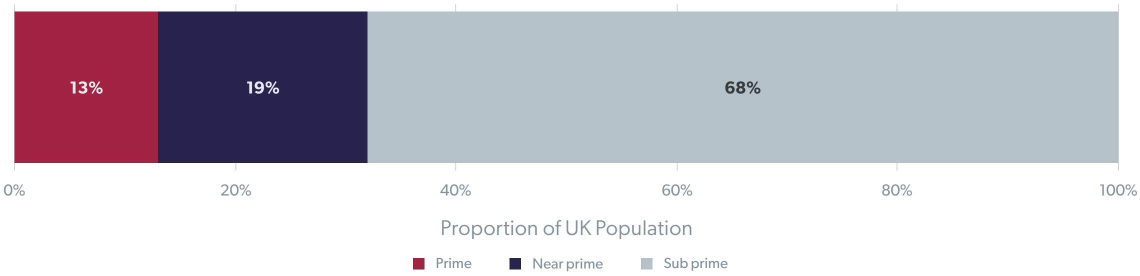
12 Fair4all Finance, *Scaling affordable credit provision: roundtable readout*; Grant Thornton, *Key issues facing consumer credit firms in 2023*; UK Finance, *Review of the statutory dispute-resolution process in the banking and finance sector*; Financial Ombudsman Service, *DRN-4326581*; Financial Times, *Provident to close UK's oldest doorstep lending business*; Financial Times, *Amigo Loans faces collapse if it fails to resolve dispute with regulators*

13 Lloyds Banking Group, *What is a credit score?*

Credit scores help to articulate how great a risk consumers are perceived to represent to lenders. Having a subprime credit score can make it harder to access credit and can lead to less favourable terms where it is offered, such as paying a higher interest rate or being given a lower credit limit.

Using our own segmentation criteria, we estimate that about 1 in 3 adults are near or sub prime consumers. This estimate is similar to PwC's attempt to define the number of underserved customers in the UK market which also measures traits that could signify near or sub prime consumers.[14] This equates to about 17 million consumers and the results are presented in Figure 1 below. For our methodology, see appendix 1.

Figure 1: Segmentation of the UK adult population for consumer credit lending.



Source: CSJ analysis of polling by Opinium (n = 4,022).

In this chapter, we briefly look at the decline in the size of two common products in the high-cost market that we have data for, namely home collected credit and high-cost short term credit.[15] We show that both markets have seen a substantial decline in their size.

Home Credit: Home credit is defined by the Financial Conduct Authority in its handbook – and therefore recorded in this data – as:

- A regulated credit agreement which is a borrower lender agreement which either provides that the sum repayable is collected by – or on behalf of – the lender at the customer's home or the home of a person who makes a payment on the customers behalf or that the customer could be expected to be collected at home.[16]

According to our data, the number of home credit agreement has declined between Q1 2012 and Q4 2023 and this can be seen in Figure 2 below. At the start of our data, about 2 million loans were originated in 2012 declining to 260,000 in 2023. The value of those loans has also declined, from just over £1.4 billion in 2012 to £611 million in 2019 when our data begins to £133 million in 2023.[17]

High-Cost Short-Term Credit: High-cost short-term credit is defined by the Financial Conduct Authority in its handbook – and therefore in this data - as:

14 PwC, *Overlooked and financially under-served: Sizing the financially under-served population in the UK*.

15 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Freedom of Information request made by the Centre for Social Justice to the Financial Conduct Authority.

16 Financial Conduct Authority, *Home credit loan agreement*.

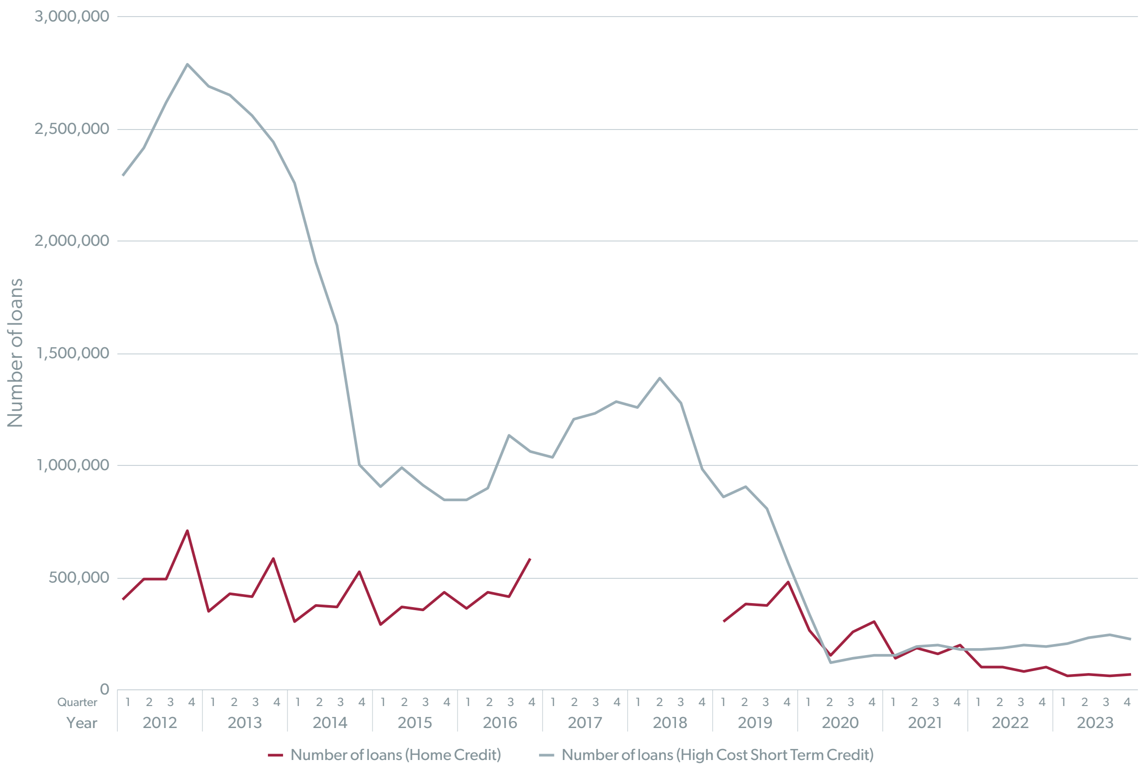
17 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Our FOI data begins from Q1 2019.

- A borrower-lender agreement or P2P agreement where the APR is equal to or exceeds 100% and is due to be repaid within 12 months. A loan of this type that is not secured by a mortgage, charge or pledge and is not a credit agreement provided by a community finance lender or home credit loan agreement, bill of sale, or an overdraft.[18]

Since 2012, there has been a considerable degree of contraction in the high-cost market. The high-cost market reduced substantially between Q4 2012 and Q1 2015 when the high-cost short term credit price cap was introduced, declining from 2.4 million to 900,000 loan originations.[19] There was a further substantial fall in the number of loans between Q2 2018 to Q4 2022. Overall, Figure 2 shows that 10 million high-cost originations were made in 2012, declining to 914,000 in 2023. The value of loans has also fallen. Over the entire period of the data, the number of loans declined by 90 per cent. The total value of loans also declined from about £2.5 billion in 2019 – the earliest point we have data for to £326 million in 2023.[20]

Taken together – these data demonstrate a substantial shift in the market. In its Dear CEO letter of March 2024, the FCA also noted a substantial change, explaining that the high-cost market had declined by 3 billion pounds of lending since 2019, with almost 250 firms exiting the market.[21]

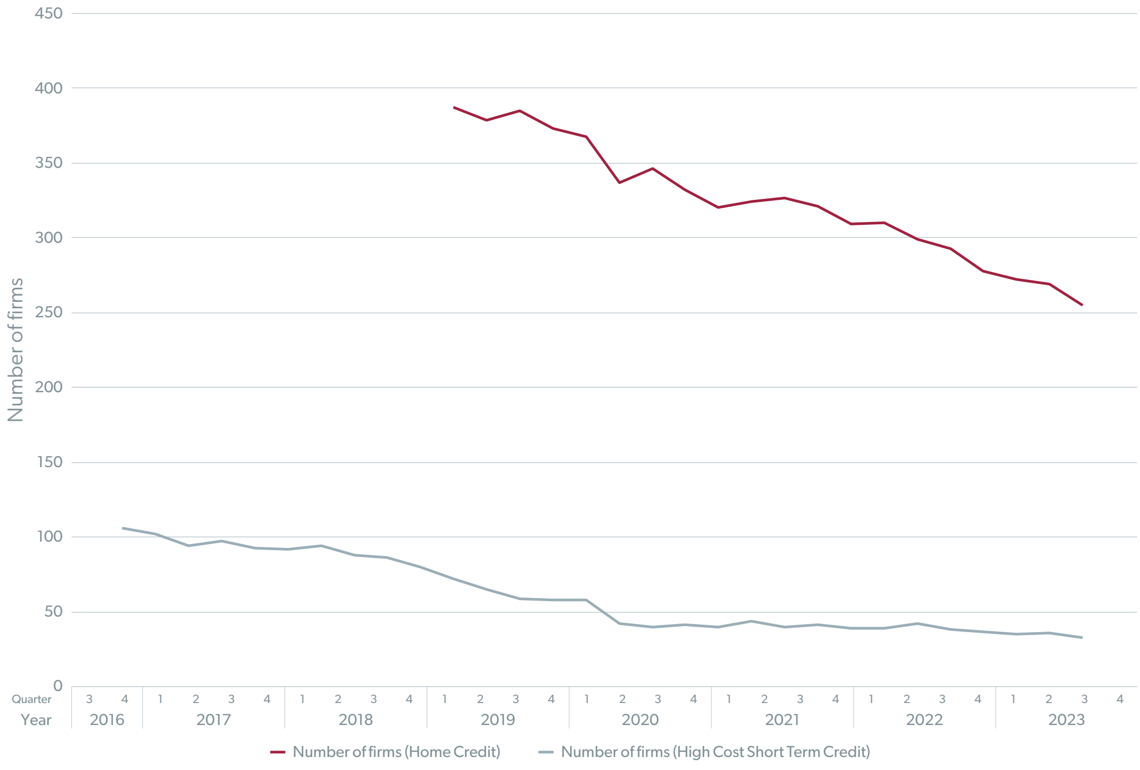
Figure 2: Number of loan originations for high-cost short-term credit and home credit.



Source: Financial Conduct Authority.[22]

18 Financial Conduct Authority Handbook, *High-cost, short-term credit*.
19 Financial Conduct Authority, *CP14/10: Proposals for a price cap on high-cost short-term credit*.
20 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Freedom of Information request made by the Centre for Social Justice to the Financial Conduct Authority.
21 Financial Conduct Authority, *Dear Chief Executive Officer: FCA Strategy for Consumer Lending*.
22 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Freedom of Information request made by the Centre for Social Justice to the Financial Conduct Authority.

Figure 3: Number of firms providing home credit and high-cost short term credit.



Source: Financial Conduct Authority.

Chapter 2:

The Changing Shape of the High Cost Credit Market

In addition to understanding how the size of the high-cost credit market has changed, we also seek to understand how its shape has changed, something we do in this chapter. This will help us to understand if the characteristics of consumers operating in the market have changed substantially between the two time periods we have data for. This evidence builds on work produced by the Financial Conduct Authority in 2017.[23]

To achieve this, we present an analysis of credit reference agency data undertaken for us by Experian. Experian is one of the three major credit reference agencies in the UK, and the high-cost lending market is defined as consumers who have taken either a home credit loan, a payday loan, or a loan from another established high-cost credit provider.

The analysis reviews two snapshots of UK consumers operating in the high-cost market for 2017/18 and 2022/23. With an analytical population of over 1,000,000 consumers who have used high-cost credit, we look at a broad range of indicators, including consumers' credit scores, their overall indebtedness, the status of their worst performing (greatest number of payments missed) credit account, and the other products they have open. We broadly find that the high-cost sector remains broadly the same, with the exception that consumers using high-cost products appear more credit active, are slightly less likely to engage in repeat lending, and – of course – the market is much smaller.

Volumes and balances

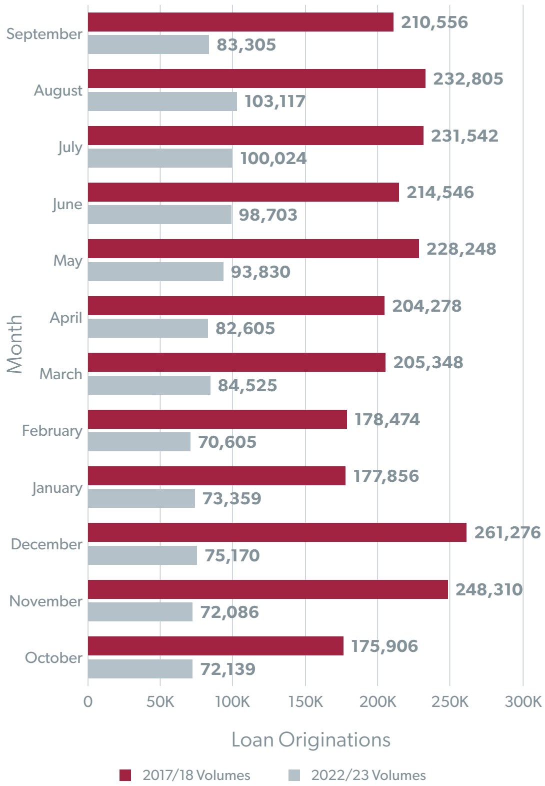
The data held by Experian confirms what we show above using FCA administrative data, namely a significant contraction in lending volumes by high-cost loan providers. Generally, this data suggests that lending volumes have declined by 60 per cent overall.[24] Interestingly, the significantly increased volume of loans made over the Christmas period present in the 2017/18 cohort appears to have disappeared for the 2022/23 cohort.

23 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Please note, our analysis is not directly comparable.

24 We cannot directly compare this to our administrative data because the FCA have not released loan originations for home collected for this period and definitions appear slightly different.

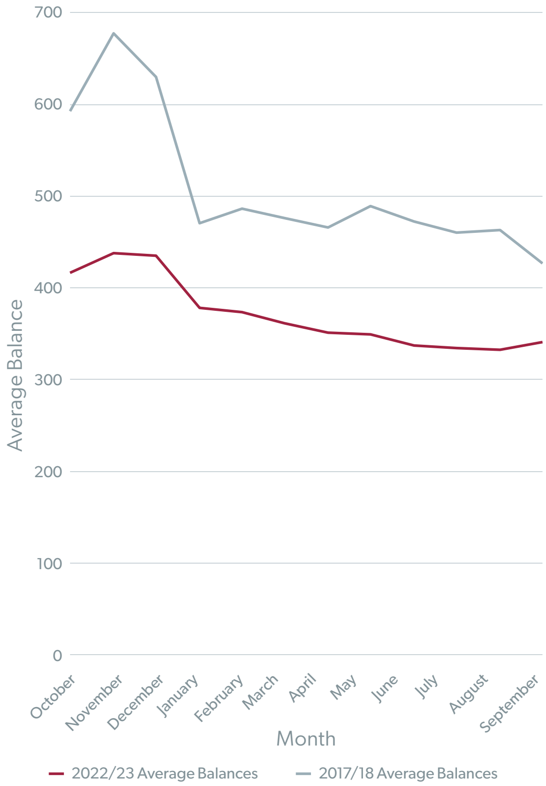
The value of new lending is also lower than it used to be. Average opening balances have declined by about £100 each month to around £350 for most of the year. Further to this, opening balances appear to have significantly reduced over the Christmas period, declining from £677 in November 2017/18 to £438 in 2022/23 respectively.

Figure 4: Volume of new lending in the high-cost market (number of loans).



Source: Experian Analysis for the Centre for Social Justice (n = 1,009,873).

Figure 5: Average balance of new lending in the high-cost market.



Source: Experian Analysis for the Centre for Social Justice (n = 1,009,873).

While the volume of lending and the balances that borrowers have taken on have declined, many of the defining features of consumers who use the high-cost market have remained the same. We will now proceed to explore a number of these metrics.

Credit risk and affordability

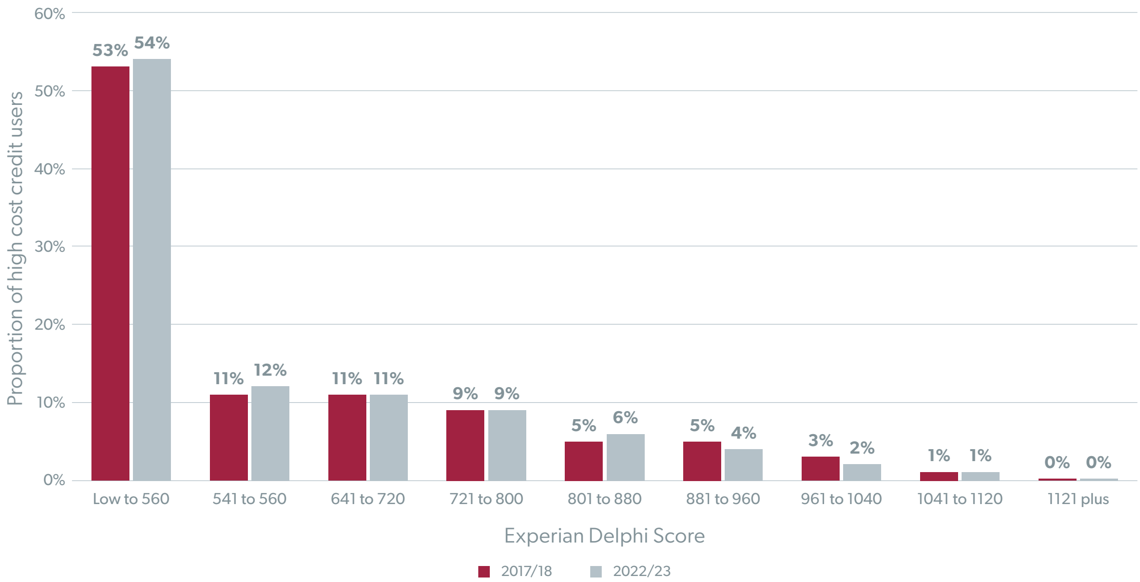
To help lenders understand how great a risk prospective customers represent when they borrow, Experian produces a Delphi score to estimate this risk and allow providers to decide on their risk tolerance. The lower the score, the greater risk a consumer is seen to represent.

What is a Delphi Score and what does it measure?

A Delphi Score is an assessment of credit risk by Experian. The higher the score a consumer has, the lower the risk they represent to an organisation that may choose to lend them money. Generally, a score of 800+ is deemed a good score.

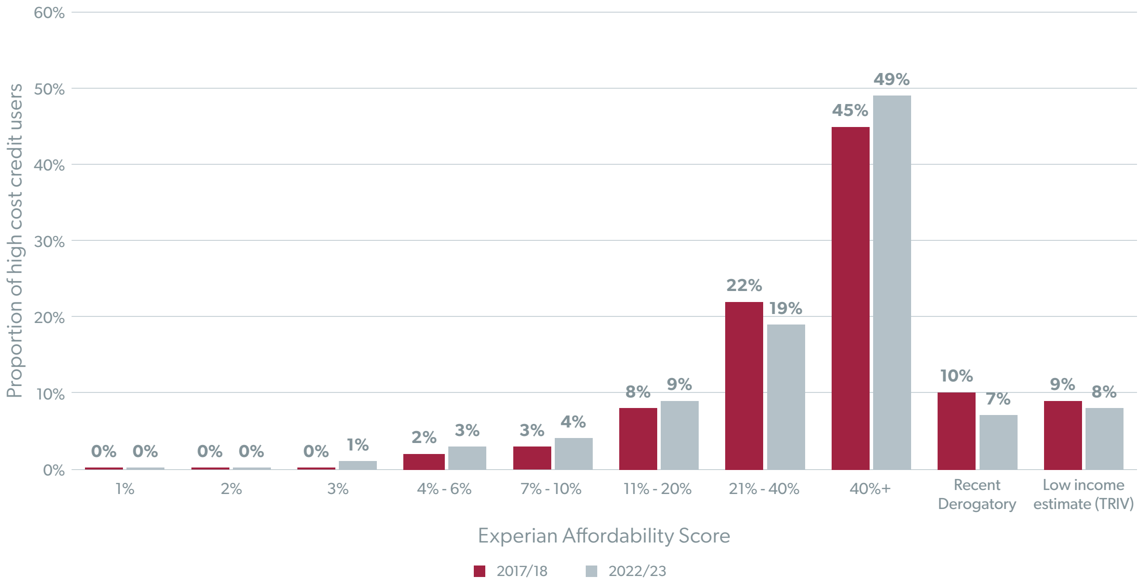
Figure 6 below shows that there has been remarkably little change in the Delphi scores of consumers who use high-cost credit. In 2017/18, 53 per cent of consumers using high-cost credit had a low to 560 score, compared to 54 per cent in 2022/23, demonstrating a non-significant change in their risk profile. Where there has been very minor change is in consumer's indebtedness / affordability profile. Experian produces an affordability rating for consumers, which is presented in Figure 7 below. A higher affordability score suggests that consumers face greater affordability issues, and derogatory data indicates where consumers show signs of affordability trouble, including a county court judgment, bankruptcy, or missing payments. This data notes that the cohort of consumers who opened a high-cost account in 2022/23 were riskier when considering their ability to repay and service their debt. 49% had an indebtedness score of over 40 – making them highly indebted - compared to just 45 per cent in 2018/19.

Figure 6: Delphi scores of consumers taking high-cost credit.



Source: Experian Analysis for the Centre for Social Justice (n = 1,009,873).

Figure 7: Indebtedness / affordability distribution of consumers taking high-cost credit.

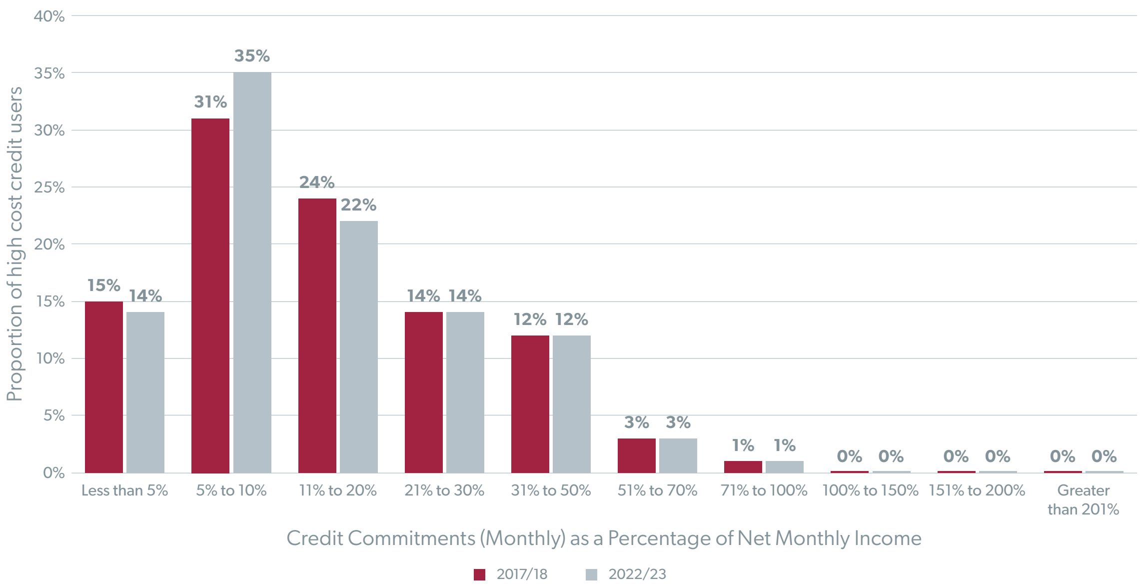


Source: Experian Analysis for the Centre for Social Justice (n = 1,009,873).

Credit commitments

A similar story emerges when Experian analysed how much of their income high-cost consumers have committed to credit repayments. This is an analysis of how much of a consumer's income is committed to their credit repayments. Experian's data suggest that there has been a slight clustering of consumers into the 5 to 10 per cent range from both those who committed slightly less of their income to credit repayments and those who committed slightly more. Overall, there does not appear to have been a remarkable change in the credit commitments of those using this market.

Figure 8: Credit commitments as a % of net monthly income of consumers taking high-cost credit.



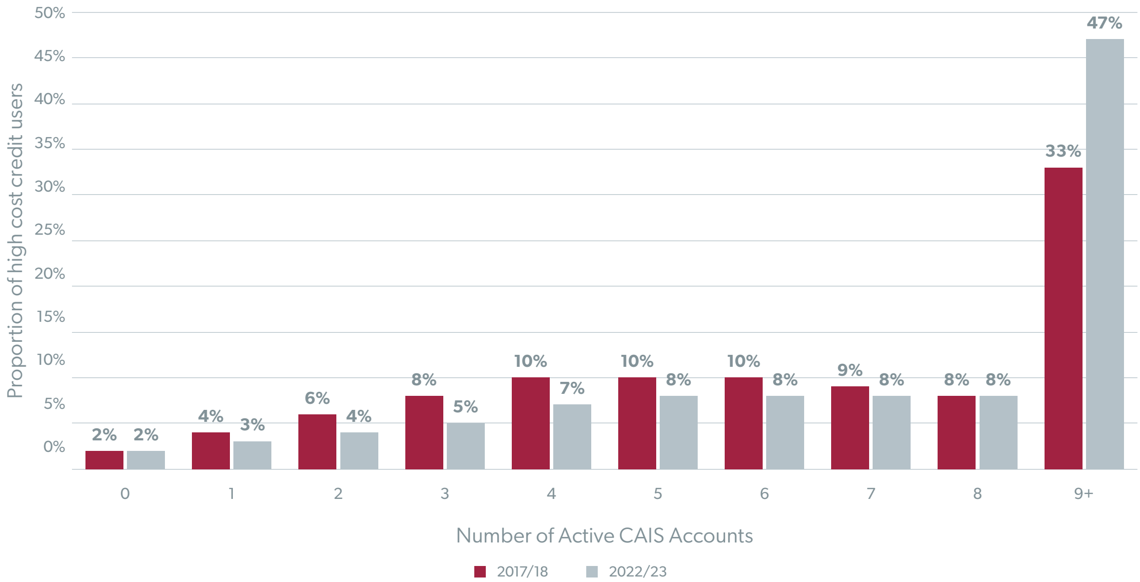
Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

Other use of credit products

Below we present Experian's analysis of the CAIS (Credit Account Information Sharing) data for those consumers who opened a high-cost short term credit account in both of our snapshot cohorts.[25] The CAIS data allows us to understand how many accounts consumers have open across different products and understand if they appear to be struggling to make repayments.

There has been a significant increase in the number of active accounts consumers hold. Amongst the 2017/18 cohort, just 33 per cent of consumers held 9 or more accounts compared to 47 per cent in the 2022/23 cohort, an increase of 14 percentage points. As we shall show later in Figure 11, this suggests two changes: the 2022/23 cohort appear to be more credit active than previous cohorts and the evolving shape of the market – particularly the introduction of Buy Now Pay Later – means consumers appear more likely to hold more accounts because of the way they are recorded by credit reference agencies.

Figure 9: Number of active credit accounts used by consumers taking high-cost credit.



Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

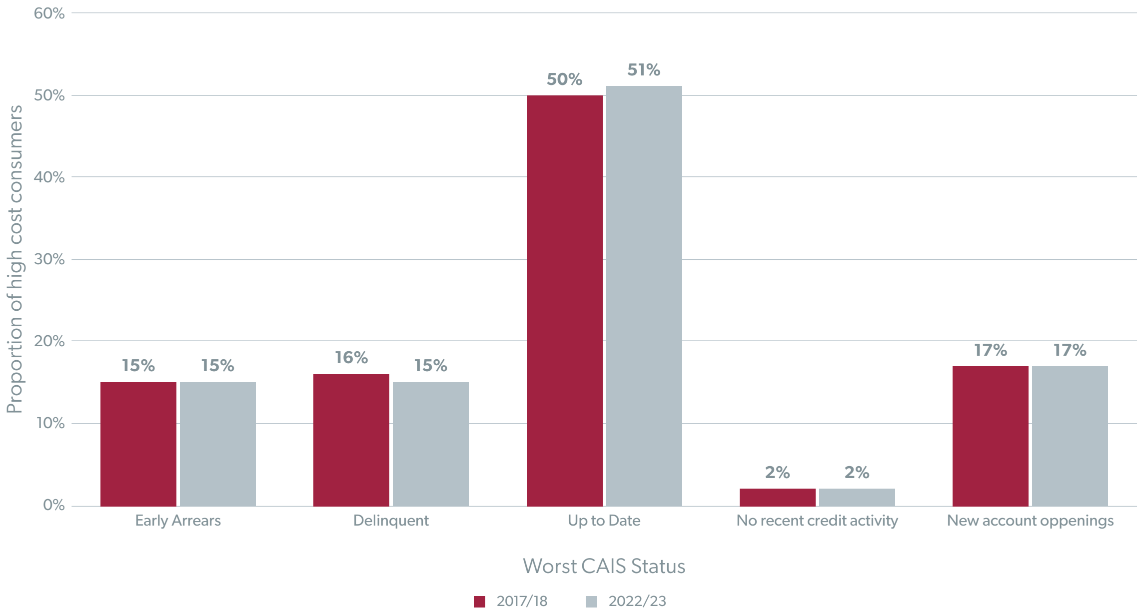
While consumers in the high-cost market might now hold more credit accounts, the distribution of arrears levels appears to have remained the same. In Figure 10 below, we show Experian's worst CAIS status, which shows how many payments consumers have missed on their worst performing account. The result is that virtually nothing has changed.

In light of the evidence we presented earlier in Figure 8, which shows that some consumers taking out high cost credit are more likely to have greater credit to income commitment percentages than they did in 2017/18, this suggests that consumers in this market have been able to maintain their repayments while facing greater commitments. Given the increase in cost-of-living pressures over the last few years, it is surprising that arrears rates have not increased, given the increase in arrears reported in the Financial Lives Survey.[26]

25 Experian, Data quality user documentation: CAIS.

26 Financial Conduct Authority, *Financial Lives Survey 2022*.

Figure 10: Worst CAIS status (arrears levels) for consumers taking high-cost credit.



Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

Turning now to the type of credit consumers use, we explore what other products consumers are taking on alongside their high-cost borrowing. We do this in Figure 11, which shows which products consumers use, and Figure 12, which breaks these products down into their submarkets. A full list of products and their definitions can be found in Appendix 2.

As referred to earlier, the 2022/23 high-cost cohort appear to be more credit active. 67 per cent of the 2017/18 cohort opened an account in a different market alongside their high-cost credit compared to 85 per cent of the 2022/23 cohort. Without knowledge of how much consumers are borrowing using these additional products, it is reasonably unclear what is happening, but it appears likely that those left in the market are using other products to make up for the borrowing they no longer undertake in the high-cost sector.

While non-traditional personal loans – such as high cost and guarantor credit – have declined, the high-cost cohort is now more likely to use non-bank credit cards. 40 per cent of the 2022/23 cohort opened a credit card account alongside their short-term lending compared to 23 per cent of the 2017/18 cohort. When broken down, Experian's data finds 37 per cent of the cohort opened a non-bank credit card compared to 19 per cent in 2017/18.

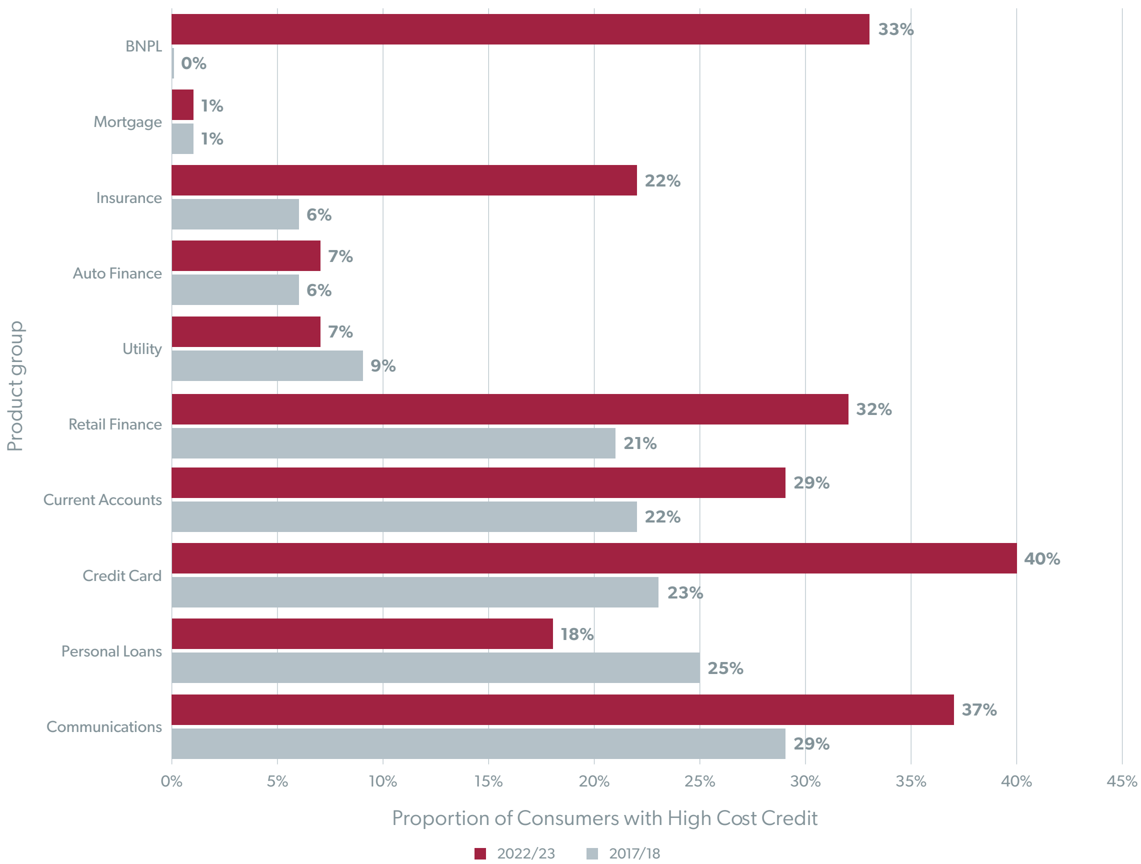
The other key message emerging from Experian's analysis is that a third of 2022/23 high-cost consumers also opened a buy now pay later account. As consumers across the credit spectrum move into the BNPL market, it is to be expected that consumers seeking short term credit, such as HCSTC, might also do so.[27] Evidence from the United States has suggested that non-prime users are more likely to use BNPL and the CSJ's own research suggests this may be true for the UK as well. [28]

27 EY, *How banks can find a winning position in the buy-now-pay-later market*.

28 Federal Reserve Bank of New York, *Liberty Street Economics: Who Uses "Buy Now Pay Later"?*; CSJ polling of consumers conducted by Opinium. We use the same definitions to segment the UK consumer credit market as found in Annex 1.

Separate CSJ research finds that 10 per cent of individuals say they currently hold Buy Now Pay Later credit (known as Deferred Payment Credit to the Financial Conduct Authority), lower than the 17 per cent of adults who said they had used BNPL in the 12 months up to May 2022 in the Financial Conduct Authority's Financial Lives Survey.[29] Noticeably, we find that the use of BNPL is significantly higher amongst subprime users, where 22 per cent say they currently hold the product, compared to just 6 per cent for prime users. This is likely to help explain the significant rise in the number of CAIS accounts amongst consumers who have taken on high-cost credit presented earlier.[30]

Figure 11: Products each cohort opened alongside their short-term lending account.

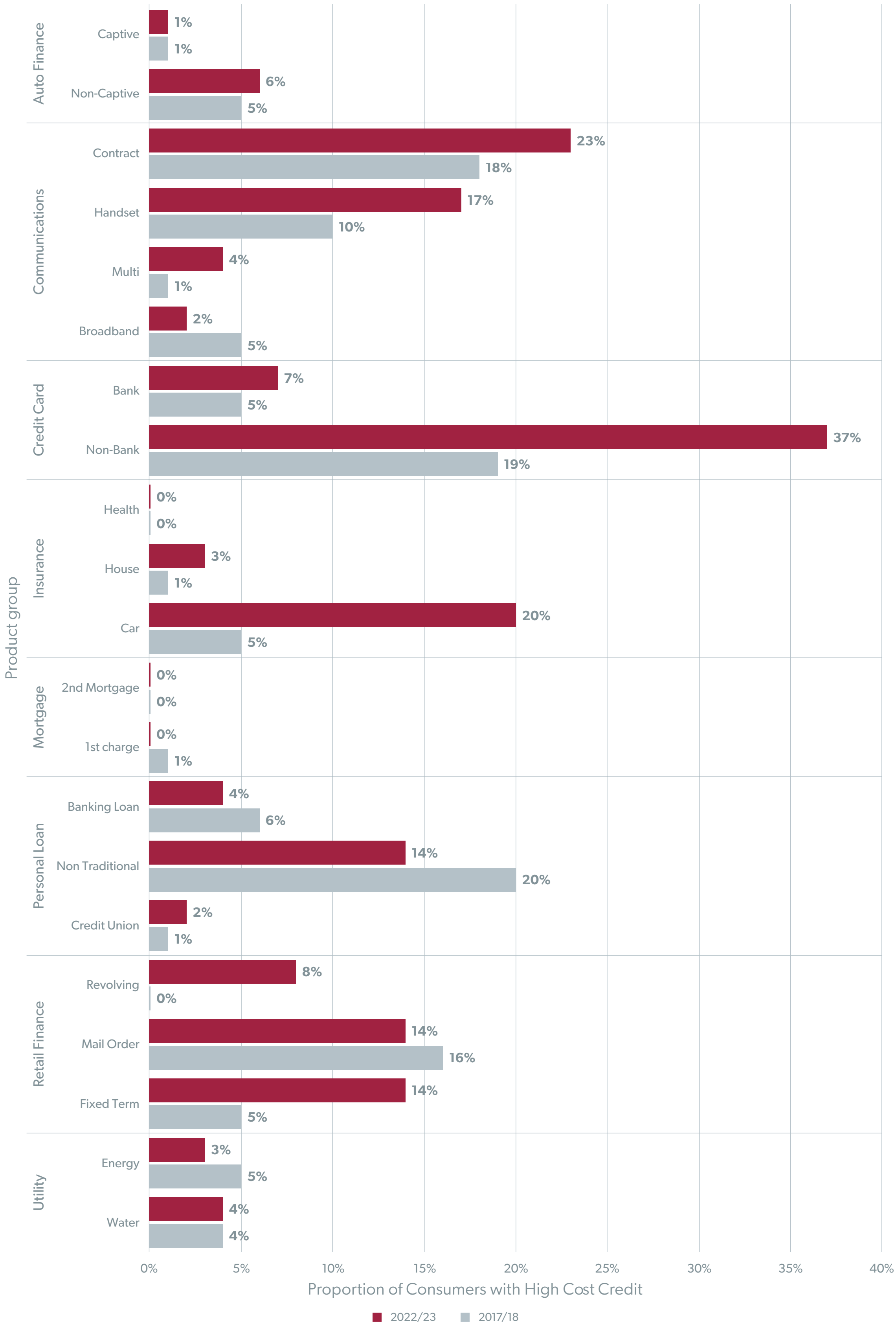


Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

29 Financial Conduct Authority, *Research Note: Deferred Payment Credit: Findings from the Financial Lives Survey*. Our survey research was undertaken between 12th – 15th September 2023.

30 Experian, *How our Buy Now Pay Later data-sharing works* Experian, *Does short-term buy now pay alter credit affect your credit score?*.

Figure 12: Products each cohort opened alongside their short-term lending account (submarkets)



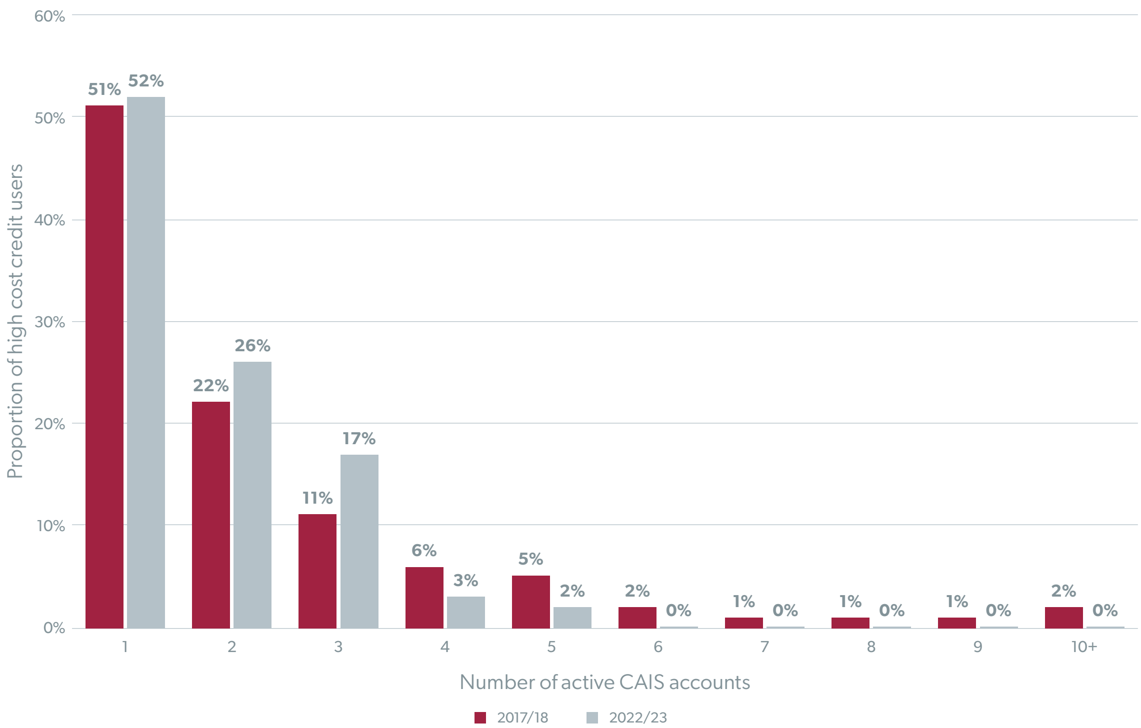
Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

Repeat lending

Finally, we take a look at the number of times consumers borrow from the same short-term lender. Experian's data tells us that while the occurrence of repeat lending has broadly remained the same, consumers who do so return fewer times. Almost a fifth – 18 per cent – of consumers in the 2017/18 cohort took on 4 or more loans compared to just 5 per cent in the 2022/23 cohort. This follows from intervention by the Financial Conduct Authority in previous years to focus on affordability checks made on consumers seeking to borrow multiple times. The FCA highlighted in a number of letters that it was concerned about how firms handled repeat lending, including nudging them into borrowing more or failing to carry out rigorous affordability checks. [31]

Looking at these data in the round, even though consumers are borrowing from high-cost providers fewer times, their increased credit activity seems to suggest that consumers who can access this form of credit have turned elsewhere in the market to substitute the borrowing that used to take place in the high-cost market. Alternative products now appear to supplement high-cost borrowing. As noted earlier, this may not be a poor outcome where consumers have substituted more costly forms of credit for cheaper ones.

Figure 13: Number of times consumers taking on high-cost credit open an account with one lender.



Source: Experian analysis for the Centre for Social Justice (n = 1,009,873).

31 Financial Conduct Authority, *Portfolio Strategy Letter to firms providing high cost lending products – 6th March 2019;* Financial Conduct Authority, *Dear CEO Affordability of HCSTC Loans – October 2018;* Financial Conduct Authority, *FCA Strategy for firms providing high-cost lending products ("high cost firms") – October 2022*.

Drawing this evidence together, in many ways the characteristics of consumers that operate in the high-cost market look fairly similar in 2022/23 to what they did in 2017/18. But there are some clear changes:

- The market has substantially declined in size, contracting by 60 per cent when measured in terms of the number of loan originations.[32]
- Repeat lending is less common following intervention by the Financial Conduct Authority
- Many consumers who are still in the market are more credit active and appear to have substituted lending that might have taken place in the high-cost market with buy now pay later and non-bank credit cards.

This last point is of particular interest because BNPL products are set to be regulated soon. If this regulation were to result in a loss of access to BNPL – which some consumers may be using to substitute lending that typically took place elsewhere – then these consumers may face an unmet credit demand and further adjustments to their credit profile over future years.

32 Here we use the figures from Experian, not the Financial Conduct Authority.

Chapter 3:
Where are They Now?

Having analysed the changing shape of the high-cost market in two cross-sectional snapshots of data from Experian, we now move on to analyse how consumers who borrowed high-cost credit in 2017/18 were performing when this analysis was conducted in 2024.

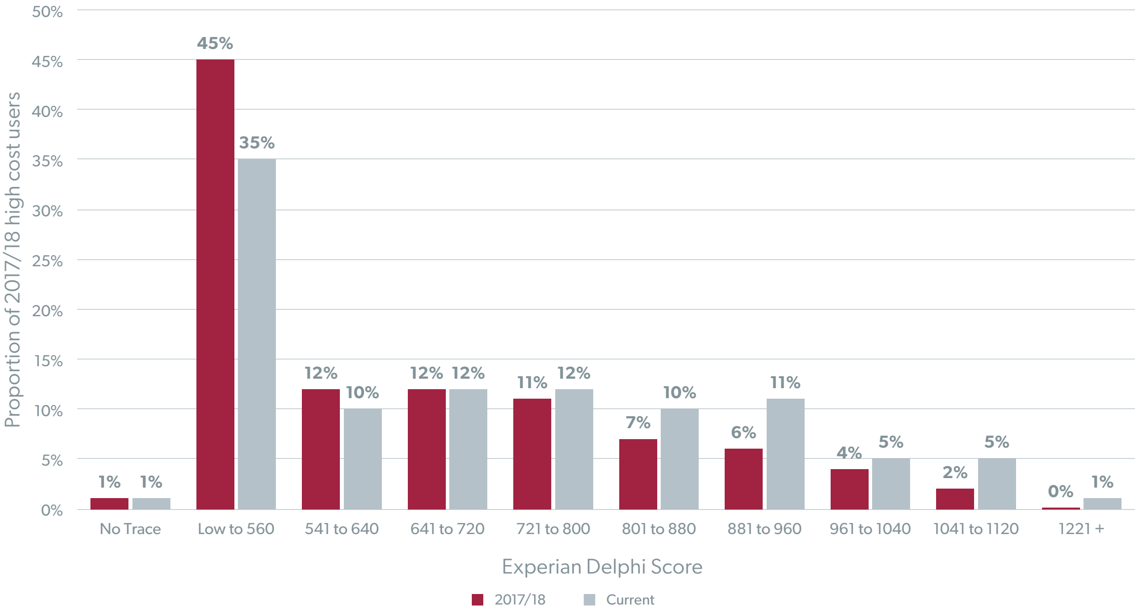
For this analysis, Experian have used the whole stock of the 2017/18 cohort and have not disentangled those who continue to use high-cost credit from those who do not. From this point onwards, the analytical population that we present has decreased by 11.5 per cent because they do not appear in the population.[33] In what follows, we present a series of data points that suggest many consumers – but far from all – in the 2017/18 cohort have improved their credit profile, complementing evidence produced by the Financial Conduct Authority in 2017.[34]

Looking again at Experian's Delphi score, we find that significantly fewer consumers have lower scores – which indicate greater riskiness – than they did in 2017/18, but a majority still have relatively low scores. Experian's affordability indicator also suggests the cohort have improved. Whereas 51 per cent of consumers taking on high-cost credit in 2017/18 were highly indebted, that has reduced to 27 per cent. It should be noted that while some of that movement has been into lower indebtedness bands, more consumers are also showing derogatory status – meaning consumers are failing to keep up with their accounts.

33 The 2017/18 cohort now consists of 894,514 units rather than 1,009,873 because about 115,000 are not present in the analytical population.

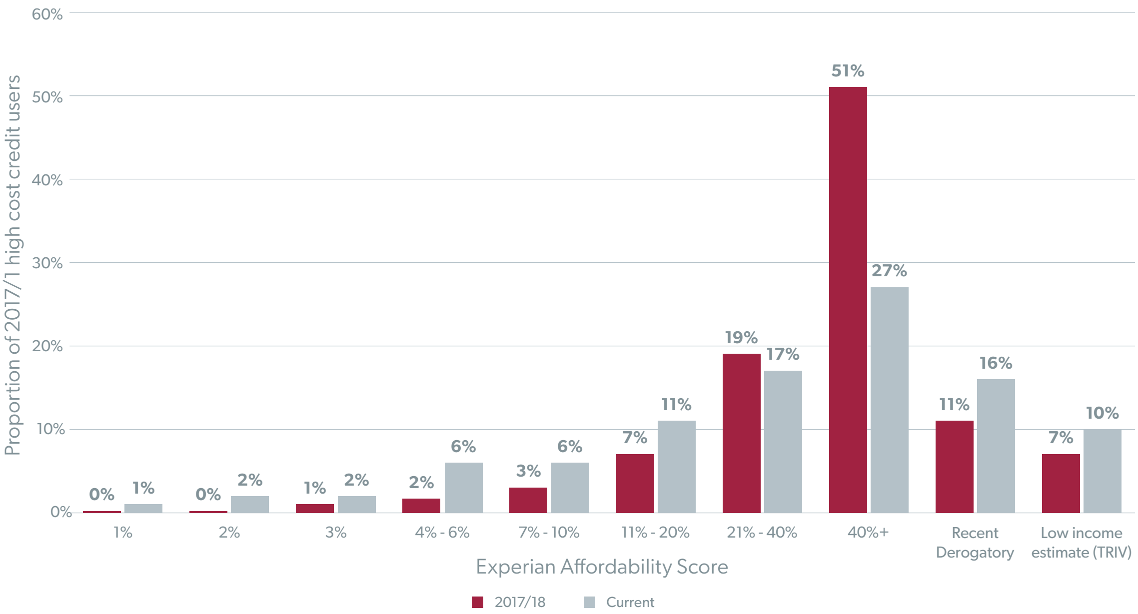
34 Financial Conduct Authority, *High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt.* Please note, our analysis is not directly comparable.

Figure 14: Delphi scores of consumers taking high-cost credit in 2017/18 compared to their current score.



Source: Experian Analysis for the Centre for Social Justice (n = 894,514).

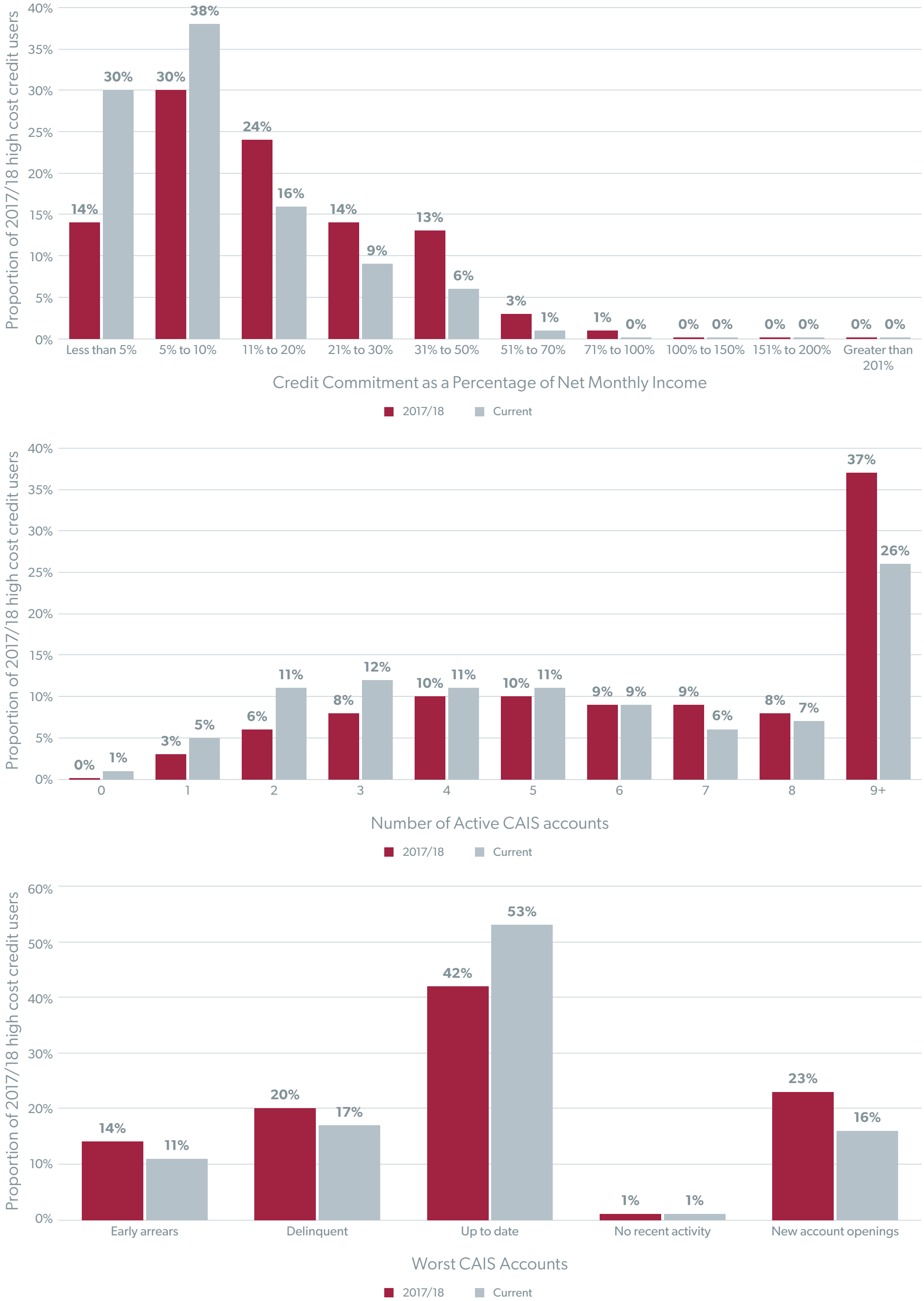
Figure 15: Indebtedness distribution of consumers taking high-cost credit in 2017/18 compared to their current indebtedness.



Source: Experian Analysis for the Centre for Social Justice (n = 894,514).

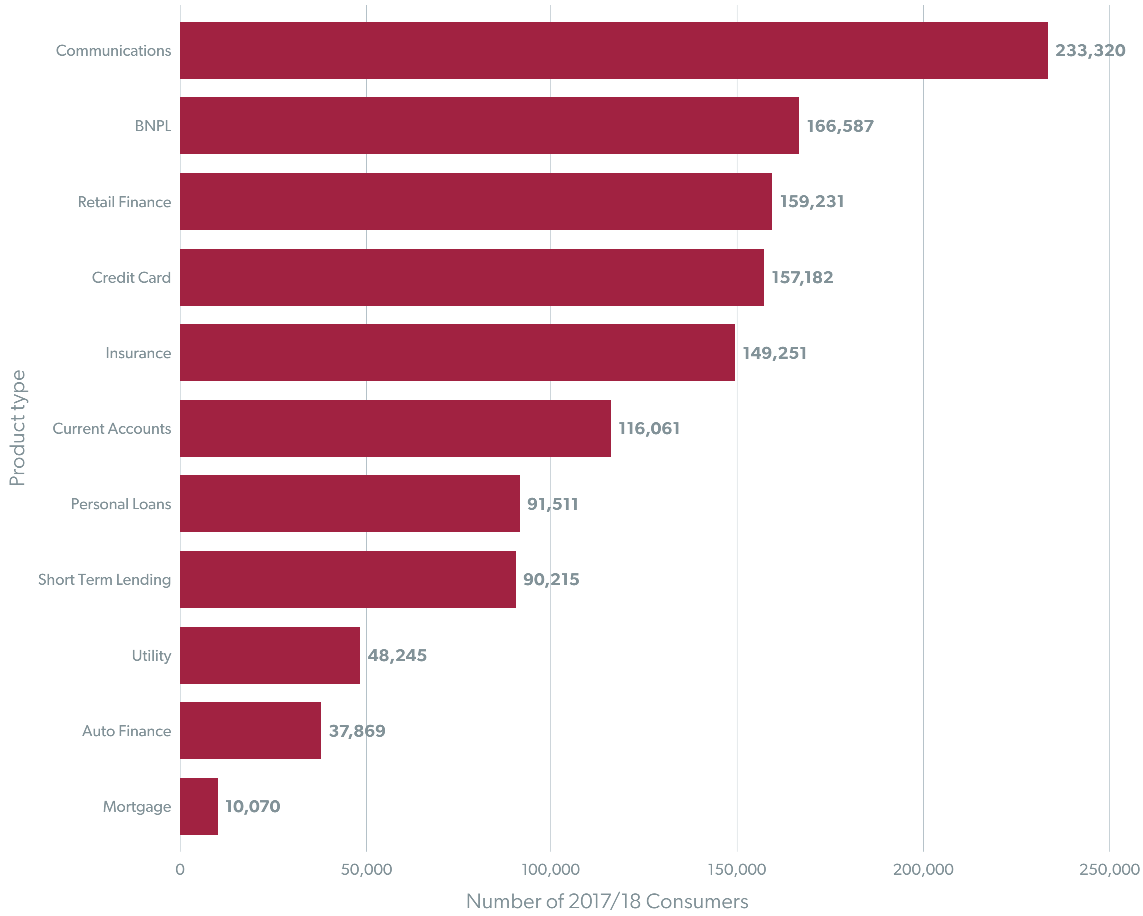
We present three further figures below that explore the credit commitments, worst account status, and number of active accounts, all of which we reviewed earlier. This further shows that the 2017/18 cohort generally owe less money as a proportion of their income, are more likely to be up to date with their accounts, and less likely to hold more accounts than they were in 2017/18.

Figure 16, 17, and 18: Credit commitments as a % of net monthly income of consumers taking high-cost credit for 2017/18 cohort compared to 2022/23; number of active credit accounts; worst credit account status.



Source: Experian Analysis for the Centre for Social Justice (n = 894,514).

Figure 19: Products opened by the 2017/18 cohort now.



Source: Experian Analysis for the Centre for Social Justice (n = 894,514).

Finally, we turn to what those consumers borrow now. Experian's data suggests that 69 per cent of consumers who borrowed high cost credit in 2017/18 opened an account in the last twelve months.

Where consumers are accessing credit, it appears to be for short term and generally lower value products, such as BNPL, and credit cards (where minimum payments are paid).

Drawing this evidence together, several key messages emerge:

- Unsurprisingly, consumers who cease to use high-cost credit – which make up a large portion of the 2017/18 sample – show signs of stronger financial health. This aligns with evidence previously produced by the Financial Conduct Authority and could be expected regardless of if consumers later borrow outside of the regulated credit market because the latter is not recorded by credit reference agencies.
- Some – but far from all – consumers appear to have turned to other credit products, including BNPL and non-bank credit cards. This suggests that a portion of high-cost users sought to substitute high-cost borrowing alternative products.

Chapter 4:

Charting a Future for Non-Prime Lending

In the analysis above, we have charted the change in both the size and shape of the high-cost credit sector, showing the recalibration the sector has undergone. We provide early evidence which indicates the presence of two groups of consumers: one who appears to have moved away from high-cost credit towards other products in the market (non-bank credit cards and BNPL) and another which appears to have moved out of the market. It is entirely likely that there are other subgroups too, especially because our data only allows us to glimpse into the second contraction in the size of the high-cost market between 2017/18 and 2022/23.

Of course, none of these developments may be a bad thing where consumers are able to manage their finances in their newly recalibrated position. Evidence from the Registry Trust, for example, makes clear that there is a strong positive linear correlation between the proportion of a local authority's population that has a CCJ and the proportion of the population that is overindebted. Where not using high cost credit leads to lower indebtedness, it is likely to be a good thing.[35]

However, since that contraction, there has been growing concern amongst both politicians and the industry that a gap has emerged in the market and that low-income households are unable to access affordable credit when they need it.[36] The Financial Conduct Authority also clearly takes this very seriously given its decision to list access to affordable credit as a priority in its portfolio letter of March 2024 and its decision to exempt some smaller lenders from its data submission requirements, citing the cost of its regulation to firms.[37]

We do not claim to have all the answers, but we hope by publishing this paper, we encourage others to believe that discussing the state of the non-prime market is worthy of our time. In what follows, we make a few passing comments and recommendations that we think could be worthy avenues of further discussion.

- The need for a broad range of stakeholders, including politicians, regulators consumer groups, and industry.
- The need to define clear expectations of the non-prime sector.
- The need to articulate what "success" looks like for the community sector and how its ambitions can be achieved.

35 Registry Trust, *A new approach to data*.

36 Fair4All Finance, *Access to credit and illegal lending*; Finance and Leasing Association, *Access to Credit: Next Steps;* Andrew Griffith MP, *Speech by the Economic Secretary to the Treasury, Andrew Griffith*.

37 Financial Conduct Authority, *PS24/3: Consumer Credit Product Sales Data Reporting*.

A broad-based debate: After a decade and a half of change and increasing concern about growing problems in the market, now appears to be the right time for a stock take of the state of the non-prime credit sector, which we recommend here.

The future of non-prime credit extends well beyond the high-cost market. The non-prime sector includes a broad range of product types and new innovations such as Buy Now Pay Later (or Deferred Payment Credit), while not without its own harms, suggest the future need not be high cost. As such, this stock take ought to include a broad range of stakeholders to fully capture the views and insights available. This ought to include all relevant parties, including politicians and government, the regulator, consumer groups, and industry. The latter we use to mean high-street banks – who are conspicuously absent from non-prime credit – specialist lenders, credit reference agencies, and lenders of other varieties too.

Together, this stakeholder group – led by the Financial Conduct Authority – should carry out an investigation into the state of the non-prime sector. We argue for the FCA to take the lead because of its ability to use its statutory powers to request data from industry participants. The culmination of the work ought to be a market study published by the FCA and a new strategy for the non-prime sector released jointly by HM Treasury, the FCA, and the PRA. The strategy should seek to outline a roadmap for change over the next five years.

Key outcomes that should be sought in this strategy include:

- An overall stock take of the state of the non-prime market;
- An articulation of the acceptable role of non-prime credit in consumer's lives;
- An understanding of when the review of the Consumer Credit Act 1974 is to go ahead and the likely implications of the review;
- An articulation of expectations about who ought to provide non-prime credit and what changes are required to bring that about. Below we discuss this in relation to the sector broadly and more specifically for the community sector.

Recommendation 1: The Financial Conduct Authority, in partnership with HM Treasury and the Prudential Regulation Authority should lead a stock take of the non-prime credit sector culminating in a joint 5-year strategy.

After a decade and a half of change, its time for a stock take of the non-prime credit market to understand how the size and shape of the market has changed and what challenges it faces today.

We recommend that the Financial Conduct Authority, in partnership with the Prudential Regulation Authority and HM Treasury, carry out this review. The review should incorporate a range of stakeholders, including the commercial and community credit sector, credit reference agencies, and mainstream banks to fully capture the change in the market.

The review should result in a joint 5-year strategy to set out a clear future for the sector.

Defining clear expectations: It is no secret that the relationship between bodies responsible for regulating the credit sector and providing redress – namely the Financial Conduct Authority and the Financial Ombudsman Service – and some actors in the industry has been difficult in the past.[38] In the past, we have been told that official bodies do not always understand the business models they regulate. Others have noted that they feel regulators have changed their mind on issues that resulted in significant disruption.[39]

We will not comment of the validity of these claims here but overcoming this should be part of any future strategy for the sector because the environment created by this mistrust has implications for the market and its ability to function. Where investors are unnerved about the potential for retrospective regulatory action, they will shy away from investing in firms where they perceive the risk to be too high. Of course, the implications of many mis-selling scandals also play a role here too. The result is that high APR rates and specific lending products are now associated with a degree of reputational risk.[40]

The relationship between the industry and regulator will never and ought never to be free of healthy tension. Afterall, the regulator and the Ombudsman exist to protect consumers and provide redress where things go wrong. However, a greater degree of clarity about the role the non-prime consumer credit sector might play and what models and products are and are not acceptable would help provide direction to the industry. In the past, the FCA has set out the strategic principles that guide its regulation and briefly discussed what APR it deems acceptable.[41] The then Chief Executive of the FCA, Andrew Bailey, noted that the cost of credit and persistent debt matter, but also that he did not believe that credit should not be available to part of the population.[42]

Any future articulation of expectations would not exempt firms from regulatory intervention and the FCA's new Consumer Duty means that, in the future, it should be more proactive at resolving poor practice where it arises.[43] It would, however, provide a greater degree of clarity for consumers, investors, and firms about what they might expect from the market.

Recommendation 2: The Financial Conduct Authority should articulate the role of the non-prime credit sector, including what models and products it deems to be inappropriate.

It is no secret that the relationship between bodies responsible for regulating the credit sector and providing redress – namely the Financial Conduct Authority and the Financial Ombudsman Service – and some actors in the market has been difficult.

The relationship between the industry and regulator will never and ought never to be free of healthy tension. Afterall, the regulator and the Ombudsman exist to protect consumers and provide redress where things go wrong. However, a greater degree of clarity about the role the non-prime consumer credit sector might play and what models and products are and are not acceptable would help provide direction to the industry. In the past, it has been argued that the fear of retrospective regulation has deterred firms from entering the market.[44]

38 Fair4All Finance, *Scaling affordable credit provision: Roundtable readout*.
39 FT Adviser, FCA finds no evidence of retrospective regulation.
40 Fair4All Finance, *Scaling affordable credit provision: Roundtable readout*.
41 Financial Conduct Authority, *High-cost credit: what next?*
42 Financial Conduct Authority, *High-cost credit: what next?*
43 Financial Conduct Authority, *PS22/9: A new Consumer Duty*.
44 Fair4All Finance, *Scaling affordable credit provision: Roundtable readout*.

Any future articulation would not exempt firms from regulatory intervention and the FCA's new Consumer Duty means that, in the future, it should be more proactive at resolving poor practice where it arises. It would, however, provide a greater degree of clarity for consumers, investors, and firms about what they might expect from the market.

Articulating what "success" means for the community sector: Over the last decade and a half, a common theme in the consumer credit sector has been the belief in the potential of the community credit sector, namely credit unions and CDFIs, to grow into the space left behind by the high-cost credit sector. Here we focus on credit unions.

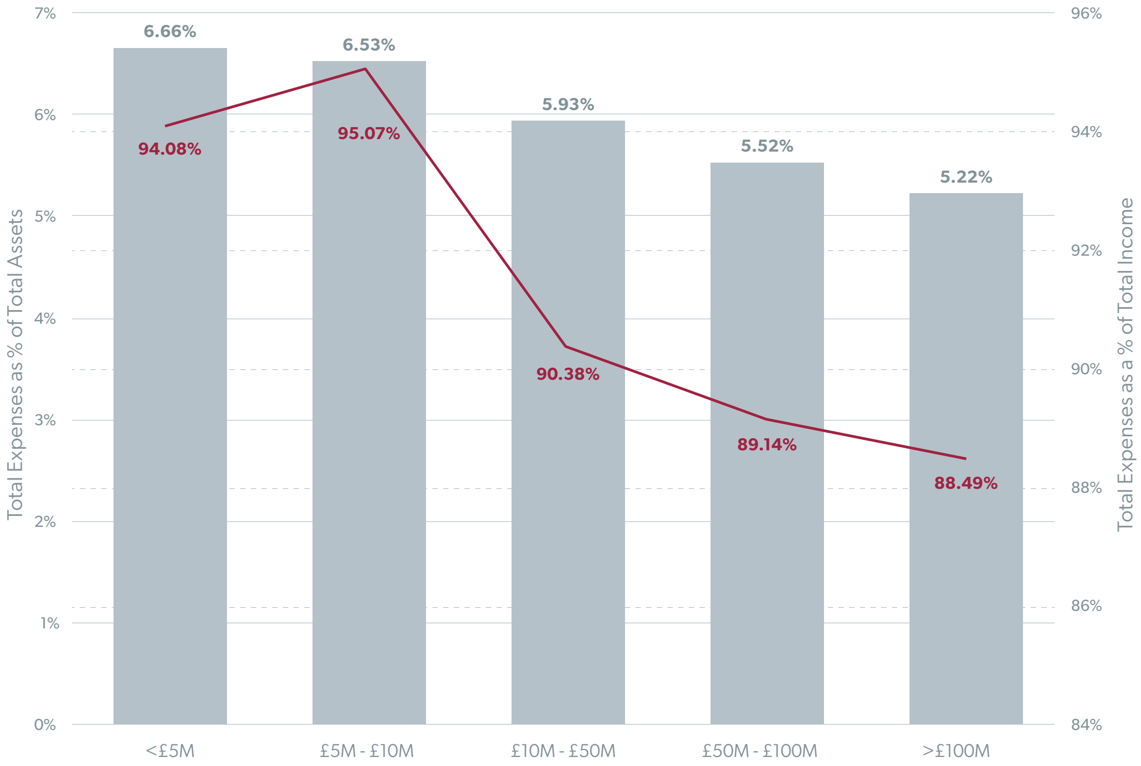
In recent years, credit unions have grown their lending significantly, but it seems fair to say that they – alongside CDFIs – have not proved to be a panacea despite significant government investment and some legislative change. For example, the government took steps throughout the 2010s to invest in a credit union shared service organisation, which did not realise material benefits and amended the Credit Union Act to allow community-based credit unions to expand to cover a geographic area encompassing 3 million potential members.[45]

The progress made to grow the sector is welcome, yet many of the problems it faces remain the same and they have been articulated before.[46] Challenges include poor IT infrastructure, the small scale many providers operate on, the resulting limited scope for marketing, limited succession planning, and, in some cases, a lack of understanding of the regulatory requirements that come with running a reputable provider of financial services.[47]

Fundamentally, these challenges appear to emerge from the small scale of many credit unions that do not have a plan for growth. Indeed, it is fair to say that some do not appear to want one. Afterall, it is the community factor that draws many customers and volunteers to the sector. A secondary contradiction emerges between the tension created by the desire to avoid being a "poor man's bank" and the perceived inability to provide a competitive rate of interest and attract customers from more established banks. To achieve progress, these issues must be ironed out. The sector cannot labour under the illusion that consumer goodwill will lead to a flurry of activity. Action and drive will be key to securing the future.

45 *Legislation.gov.uk*, *The Credit Unions Act 1979 (Locality Common Bond Conditions) Order 2017*.
46 Financial Conduct Authority, *Charles Randell: Is this the decade of the credit union?*
47 Financial Conduct Authority, *Charles Randell: Is this the decade of the credit union?*

Figure 20: Total expenses ratios for credit unions in Great Britain grouped by total assets size.



Source: Prudential Regulation Authority.[48]

As we noted in *Swimming with Sharks*, we envision bigger, bolder credit unions that take a larger role in providing financial services to households across the income spectrum and we recommended the government take steps to help the sector consolidate by providing capital investment for strategic mergers and digital upskilling. [49] We also suggested that the government update the Credit Union Act 1979 to create a framework that allows larger credit unions that want to grow to do so by loosening the restrictions around geographic common bonds. Evidence produced by the Prudential Regulation Authority presented in Figure 20 above shows that larger credit unions are those which spend a smaller proportion of their revenue maintaining their operations, leaving more resources available for other priorities.[50]

To help iron out these contradictions, we recommend the Government establish a programme of work, which could be part of its broader strategy described above, to articulate its expectations for the community sector and define what "success" looks like. This should be accompanied with a raft of reforms to existing legislation to ensure that providers that want to grow can do so while complying with robust regulatory regime befitting of the size of the provider in question.

48 Prudential Regulation Authority presentation at ABCUL, March 2023.
49 Centre for Social Justice, *Swimming with Sharks: Tackling illegal money lending in England*.
50 Prudential Regulation Authority presentation at ABCUL, March 2023.

Recommendation 3: The Government should set out a plan for the growth of the community credit sector.

Over the last decade and a half, a common theme in the consumer credit sector has been the belief in the potential of the community credit sector, namely credit unions and CDFIs, to grow into the space left behind by the high-cost credit sector. Despite some growth, the community sector has represented a panacea and many of the challenges it faces remain the same as in the past, such as their small scale.

To overcome these challenges, we recommend the Government establish a programme of work to articulate its expectations for the community sector and define what "success" looks like. This should be accompanied with a raft of reforms to existing legislation to ensure that providers that want to grow can do so while complying with robust regulatory regime befitting of the size of the provider in question.

List of Recommendations

Recommendation 1

The Financial Conduct Authority, in partnership with HM Treasury and the Prudential Regulation Authority should lead a stock take of the non-prime credit sector culminating in a joint 5-year strategy for the sector.

Recommendation 2

The Financial Conduct Authority should articulate the role of the non-prime credit sector, including what models and products it deems to be inappropriate.

Recommendation 3

The Government should set out a plan for the growth of the community credit sector.

Annex 1:
Segmenting the UK Population

As part of our analysis of the UK credit market, we have segmented consumers into broad groups that help us to understand their ability to access credit and the price they are likely to pay for it. We define these groups as "Prime", "Near Prime" and "Sub Prime" and these terms are widely used in the UK and international lending market.

To achieve this segmentation, we asked two screening questions to respondents that were used to segment them into the aforementioned groups. These were the following:

Sub Prime consumers were defined as those who told us:

- Bankruptcy imposed
- County Court Judgement (CCJ) for credit related matters
- A decree for credit related matters
- Debt Relief Order
- Minimal asset process
- Individual Voluntary Arrangement (IVA) (i.e. an agreement made with your creditors to pay off your debt over a set period of time)
- Protected Trust Deed (i.e. an agreement made with your creditors to pay off your debt over a set period of time)
- Voluntary arrangement plan with a credit lender

Near Prime consumers were defined as those who told us:

- I am a new borrower to the credit market i.e. I have never borrowed / had credit before and therefore don't have a credit foot print in the UK
- I am new to the UK credit market i.e. I have only recently moved to the UK so don't have a credit foot print in the UK
- I have had issues with my borrowing in the past i.e. I have missed one or more payments e.g. credit card bills, loans repayments etc.
- I am currently taking steps to re-build my credit score having had problems in the past
- I have an inconsistent income e.g. No set working hours/ Zero-hour contract

Prime consumers were defined as consumers who did not mention any of the above.

Annex 2:

Product Definitions

Title	Description
Hire Purchase / Conditional Sale	An Account where the merchandise remains the property of the lender until all repayments are completed
Unsecured Loan (Personal Loans)	An Account covering the borrowing of a fixed amount which is not secured
Mortgage	A loan for the purpose of a property that is secured by a mortgage deed until the final payment is made
Budget (revolving Account)	A provision of an account or an agreement for the purchase of goods up to an agreed credit limit. A revolving account may involve numerous draw downs and repayments of a percentage of the balance, whereas the budget account's credit facility is repaid by constant, regular amounts
Credit Card / Store Card	Where customers are allowed to spend up to an agreed credit limit and repayments are a minimal value or a percentage of the balance outstanding
Mail Order	For all types of mail order portfolios
Current Accounts	For all portfolios operating along the lines of current accounts (see Appendix 8)
Second Mortgage (secured loan)	A loan secured against an asset or property but the security ranks after the prime mortgage above
Communications	For use by mobile phone, cable or landline communication service providers
Fixed Term deferred payment	'Buy now pay later' types of arrangements. The conditions are similar to HP and credit sale, except that the first payment is deferred for an agreed period of time (see Appendix 10)
Utility	This covers gas, water and electricity portfolios, but does not cover communications
Payday Loans	Short terms loans, generally secured against salary payments often no more than 1 month in length
Store Card	Where customers are allowed to spend up to an agreed credit limit and repayments are a minimal value or a percentage of the balance outstanding; store cards are issued for the use within a specific retailer or group
Water	Utility account for water services
Gas	Utility account for gas services
Electricity	Utility account for electricity services
House Insurance	Credit for house insurance services
Car Insurance	Credit for car insurance services

Title	Description
Health Insurance	Credit for health insurance services
Mobile	An account for mobile phone services
Fixed Line	An account for fixed line telecommunications
Cable	An account for cable entertainment services
Satellite	An account for satellite entertainment services
Broadband	An account for broadband services
Multi Communications	An account for multiple communication services i.e. mobile, fixed line, cable, satellite, broadband or a combination of these
Short Term Deferred Payment Credit	Short-term transactions that are repaid in less than 3 months (Individual accounts for each transaction with a Unique Account number per transaction) or Short-term transactions that are repaid in less than 3 months with Credit Limit (Individual accounts for each transaction with a Unique Account number per transaction)
Home Credit	The provision of credit, typically for small sum loans, on flexible terms, the repayments for which are collected in instalments by collectors who call at the customers home

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